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Mayor

26 Member
Metro Council

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Audit Report

Office of Internal Audit



Inspections, Permits and Licenses

Public Protection

May 2003

Inspections, Permits and Licenses

Public Protection

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LOUISVILLE, KENTUCKY

OFFICE OF INTERNAL AUDIT

JERRY E. ABRAMSON
MAYOR

RON WESTON
PRESIDENT, METRO COUNCIL

Transmittal Letter

May 19, 2003

The Honorable Jerry E. Abramson
Mayor of Louisville Metro
Louisville Metro Hall

Re: Attached Audit of the Inspections, Permits and Licenses Public Protection Division

Scope and Opinion

We have examined the operating records and procedures of the former Jefferson County Public Protection Division. The Metro Department of Inspections, Permits and Licenses (IPL) now administers this division. The primary focus of the audit was the operational and fiscal administration of the activity.

As a part of our examination, we performed an evaluation of the internal control structure. Our examination was conducted in accordance with Generally Accepted Government Auditing Standards (1994 Revision), issued by the Comptroller General of the United States; with the Standards for the Professional Practice of Internal Auditing issued by the Institute of Internal Auditors; and Generally Accepted Auditing Standards to the extent we considered necessary to evaluate the system.

The objective of internal control is to provide reasonable, but not absolute, assurance regarding the achievement of objectives in the following categories:

- Effectiveness and efficiency of operations
- Reliability of financial reporting
- Compliance with applicable laws and regulations
- Safeguarding of assets

There are inherent limitations in any system of internal control. Errors may result from misunderstanding of instructions, mistakes of judgment, carelessness, or other personnel factors. Some controls may be circumvented by collusion. Similarly, management may circumvent control procedures by administrative oversight.

The operating procedures associated with Public Protection Division were reviewed through interviews with key personnel. The operational and fiscal administration of activity was reviewed. The specific topics reviewed included the following:

- Revenue Management
- General Administration
- Alcoholic Beverage Control
- Escort Bureau
- Armed Security
- Charitable Solicitation
- Adult Entertainment

The scope and methodology of the areas reviewed will be addressed in the Observations and Recommendations section of this report. Our examination would not reveal all weaknesses because it was based on selective review of data.


The internal control rating for each area reviewed is on page 5. These ratings quantify our opinion regarding the internal controls used in managing the activity and identify areas requiring corrective action.

It is our opinion that the overall internal control structure for the Public Protection Division is weak. There were some specific problems that indicate the internal control structure could be more effective. Examples of the problems include the following.

- Poor cash management and inadequate safeguarding of assets. Funds are not properly secured and may be held for extended periods before deposits are made.
- Monitoring and reconciliation of revenue activity is inadequate. This lack of oversight does not adequately protect the revenue and weakens the reliability of the financial statements.
- Files do not contain sufficient documentation to ensure that payments adhere to requirements. The format of files does not provide adequate detail to verify that the correct amounts are paid. This weakens the reliability of records and the financial statements.
- The licensee files are not managed adequately. Information is often incomplete or missing. This hampers the efficiency and effectiveness of information management, as well as, weakens the reliability of records.
- Functional operating policies and procedures are not provided for staff. This may lead to inconsistencies in administration and management of activities.

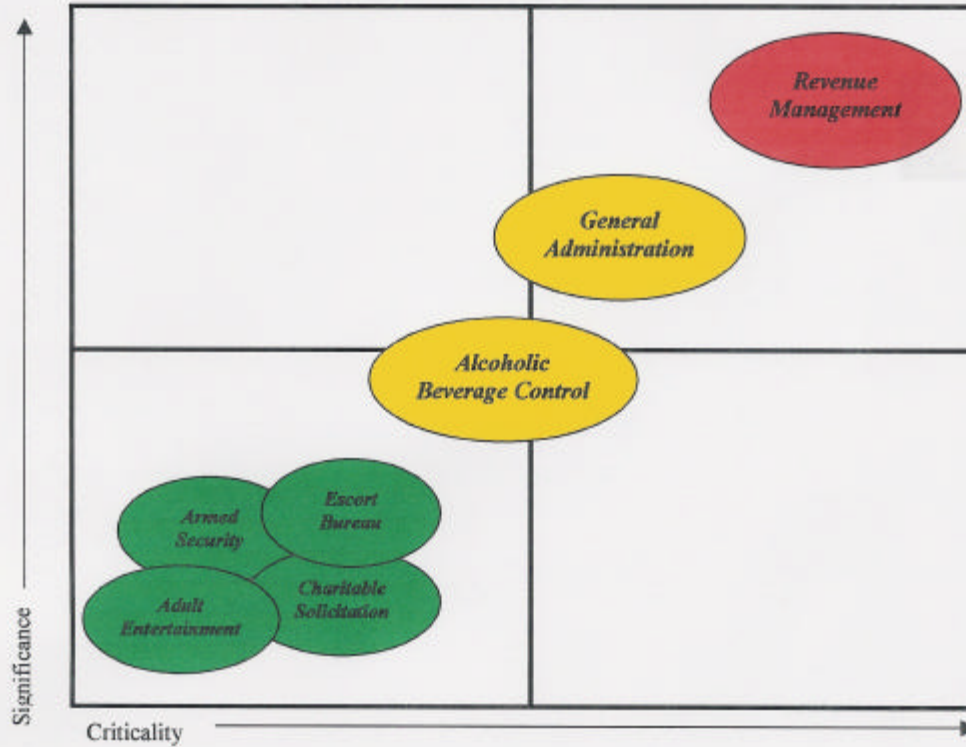
The Department of Inspections, Permits and Licenses has proactively assessed the Public Protection Division operations and implemented several new policies and procedures that should address many of the concerns noted in this audit report. The implementation of

the recommendations in this report will help improve the internal control structure and effectiveness of activity administered by the Public Protection Division.


Michael S. Norman, CIA
Chief Audit Executive

cc: Louisville Metro Council Audit Committee
Louisville Metro Council Members
Deputy Mayors
Secretary of the Cabinet for Public Works and Services
Director of Inspections, Permits and Licenses

Internal Control Rating



<u>Legend</u>			
<u>Criteria</u>	<u>Satisfactory</u>	<u>Weak</u>	<u>Inadequate</u>
<u>Issues</u>	Not likely to impact operations.	Impact on operations likely contained.	Impact on operations likely widespread or compounding.
<u>Controls</u>	Effective.	Opportunity exists to improve effectiveness.	Do not exist or are not reliable.
<u>Policy Compliance</u>	Non-compliance issues are minor.	Non-compliance issues may be systemic.	Non-compliance issues are pervasive, significant, or have severe consequences.
<u>Image</u>	No, or low, level of risk.	Potential for damage.	Severe risk of damage.
<u>Corrective Action</u>	May be necessary.	Prompt.	Immediate.

Introduction

The Public Protection Division has the administrative responsibility for issuing licenses for certain businesses and employees, along with providing related identification cards. This involves determining eligibility based on applicable requirements and monitoring violations. Public Protection conducts administrative court to enforce laws relating to Alcoholic Beverage Control. The following are the specific topics administered by the Public Protection Division:

- **Adult Entertainment Licensing.** Jefferson County Ordinance Chapter 111 regulates licensing requirements for adult entertainment establishments and their employees. This requires Public Protection to administer the licensing and renewals of applicants, receive licensing fees, and issue work identification cards upon approval. Adult entertainment establishment and employee licenses are valid from July 1 to June 30, and license fees range from \$25 for employees to \$1,000 for establishments. Approximately \$2,000 of revenue has been collected as of January 2003.
- **Alcoholic Beverage Control Licensing and Enforcement.** Kentucky Revised Statute Chapter 243 and Jefferson County Ordinance Chapter 113 regulate licensing requirements for establishments serving or selling alcoholic beverages. This requires Public Protection to administer the licensing and renewals of applicants, receive licensing fees, conduct administrative court for violators, and maintain a database of violations. Alcoholic beverage control licenses are valid from July 1 to June 30, and fees range from \$50 for a beer license to \$1,400 for a liquor drink license. Administrative court fines typically range from \$100 to \$1,000. Approximately \$344,000 of revenue has been collected as of January 2003.
- **Armed Security Licensing.** Jefferson County Ordinance Chapter 124 regulates licensing requirements for armed security businesses and their employees. This requires Public Protection to administer the licensing and renewals of applicants, receive licensing fees, and issue work identification cards upon approval. Armed security company and employee licenses are valid for one year from the issue date, and license fees range from \$10 for employees to \$100 for agencies. Approximately \$3,600 of revenue has been collected as of January 2003.
- **Charitable Solicitation Licensing.** Jefferson County Ordinance Chapter 117 regulates licensing requirements for charitable solicitors. This requires Public Protection to administer the registrations and renewals of applicants, receive licensing fees, and review the financial reports of charitable organizations, professional fundraisers, and professional fundraising consultants. Charitable solicitation licenses are valid from January 1 to December 31, and license fees range from \$25 for charitable organizations to \$200 for professional fundraisers. Approximately \$12,000 of revenue has been collected as of January 2003.
- **Escort Bureau Licensing.** Jefferson County Ordinance Chapter 125 regulates licensing requirements for escort bureaus and their employees. This requires Public Protection to administer the licensing and renewals of applicants, receive licensing fees, and issue work identification cards upon approval. Escort bureau licenses are valid from July 1 to June 30 with a fee of \$5,000, and escort employee licenses expire every three years on the employee's birth date and are \$100. Approximately \$7,000 of revenue has been collected as of January 2003.

The Public Protection Division operating budget is \$424,200 for fiscal year 2003.

This audit was requested by the Director of Inspections, Permits and Licenses.

Summary of Audit Results

I. Current Audit Results

See Observations and Recommendations section of this report.

II. Prior Audit Issues

The Office of Internal Audit has not conducted any reviews of the (former) Jefferson County Public Protection Division.

III. Statement of Auditing Standards

Our audit was performed in accordance with Generally Accepted Government Auditing Standards (1994 edition) issued by the Comptroller General of the United States and with the Standards for the Professional Practice of Internal Auditing (2001 edition) issued by the Institute of Internal Auditors.

IV. Statement of Internal Control

We conducted a formal study of the internal control structure in order to obtain a sufficient understanding to support our final opinion.

V. Statement of Irregularities, Illegal Acts, and Other Noncompliance

Our examination did not disclose any instances of irregularities, any indications of illegal acts, and nothing came to our attention during the examination that would indicate evidence of such. Any significant instances of noncompliance with laws and regulations are reported in the Observations and Recommendations section of this report.

VI. Views of Responsible Officials

An exit conference was held at the Office of Internal Audit Administrative Offices on April 16, 2003. Attending were William Schreck, Charles Diggs and Glenn Smith representing the Department of Inspections, Permits and Licenses; Mike Norman and Mark Doran representing Internal Audit. Final audit results were discussed.

The views of the Department of Inspections, Permits and Licenses officials are included as responses in the Observations and Recommendations section of the report.

Observations and Recommendations

Revenue Management

Scope

Key Public Protection personnel were interviewed in order to review the operational and fiscal administration of revenue and associated activity. This included the processing, records management, and monitoring associated with receipts for licensing fees, enforcement fines, and miscellaneous administrative fees.

Three Public Protection Division revenue deposits were judgmentally selected from the period of March 1, 2002 through January 31, 2003. The review consisted of examining deposit transmittals, armored car receipts, and deposit tickets. The associated receipts were verified to the financial system statements to determine the completeness, accuracy, and appropriateness of the amounts processed. The following concerns were noted.

Observations

There were some major problems noted with the management of revenue activity. As a result, the internal control structure is inadequate. Examples of the weaknesses include the following.

- Funds received are not adequately secured. This increases the risk of loss and creates employee safety issues associated with holding funds. The following concerns were noted.
 - Funds received may be held in the office for an extended period (e.g., several weeks). This is poor cash management.
 - As funds are collected, they are maintained inside a locked box or an unlocked cash tray in a desk drawer.
 - Funds being held for deposit are locked in a cabinet located in a closet. This closet has an additional door. While some physical efforts have been made to secure the second entrance (e.g., cabinet partially blocks the door), it is not known who may actually have access.
- The Public Protection office also receives deposits from other unrelated departments. These deposits are delivered to Public Protection so that the armored car service has a single pickup station. There is not proper documentation of custody for these funds and they are not adequately secured.
- There is not sufficient monitoring of revenue activity. Deposits are not reconciled to the source documents (e.g., license fee collections) or to the financial statements.
- Pre-numbered cash receipts are used during revenue transactions, however issuance and use of these receipts is not monitored. This diminishes the effectiveness of this control.

- The Public Protection office charges miscellaneous fees for notary services and copies of public records. The basis of these fees has not been documented. An opportunity exists for Public Protection to evaluate the appropriateness of the fees, as well as the amounts charged.
- Inspections, Permits and Licenses (IPL) has implemented new procedures intended to improve revenue management. Public Protection staff now process activity using the IPL permitting system and deposits are ultimately processed through the IPL administrative office. The associated processing changes are expected to improve the activity, but may need to be refined to adequately address all concerns. The following are some examples of concerns at the Public Protection location.
 - Separation of duties is not established between the processing of activity and the acceptance of funds. The individual serving as cashier also has processing responsibilities for certain types of licenses. Additionally, the cashier has access to activity reports that allow for the monitoring of revenues collected.
 - Currently, there is only one Public Protection employee with access to perform the cashier function. No backup has been trained to serve in this staff member's absence and staff have not been instructed how to proceed in such an instance.

Recommendations

Appropriate Inspection, Permits and Licenses personnel should take corrective action to address the concerns noted. Specific recommendations include the following.

- All funds should be maintained in a secure location and access should be limited to authorized individuals.
- Deposits should be submitted timely. Timeliness should consider applicable policies and procedures, as well as, the ability to hold funds in a secure environment.
- Ideally, Public Protection should not be responsible for the funds for four other departments. Each department should be responsible for the deposit of its funds. However, due to the logistics and the location, assigning custody to one department may be the most economical way to process activity. If this is the case, then additional compensating controls, such as documentation of transfers and chain of custody of funds, should be implemented.
- Custody should be documented any time funds are transferred from one individual to another. This can be accomplished through the use of signature / verification logs.
- Public Protection should reconcile their support documentation, such as cash receipts and other transaction documentation, to determine accurate deposit totals.
- Public Protection should take the opportunity to evaluate the appropriateness of the miscellaneous fees, including the amounts charged. The basis for the fees should be properly documented.
- A major component of any reporting system is proper reconciliation and monitoring. It is imperative that administrative staff review the information on a regular basis. This includes ensuring that all receipt logs are monitored so that there are no gaps in sequential numbers, along with verification of receipts to the revenue records and, ultimately, to the financial statements. In order to promote proper segregation of

duties, an administrator independent of the actual processing of activity should perform this function.

- The use of the former City permitting system should help enhance revenue management. Several internal controls are inherent in the system and activity reports should be more useful for monitoring and reconciliation purposes.
- Public Protection should ensure proper separation of duties in the process of accepting funds and preparing funds for deposit. The following concepts should be incorporated into the policies and procedures.
 - ✓ Employees should not have the ability to both receive funds and view the activity reports (e.g., Current Drawer Totals).
 - ✓ The cashier and an independent staff member (e.g., supervisor) should verify funds at the close of the shift.
 - ✓ The cashier and verifier should complete a deposit verification form, including the deposit amount, date, and both their signatures.
 - ✓ The cashier should lock the funds in a secure bag, and release the bag to the designated individual for transport to IPL's administrative office. Only the cashier and individual receiving funds at the IPL office should have keys to this bag.

Department of Inspections, Permits and License Response

Immediately upon merging with the Public Protection office we made many of these same observations and began taking steps to alter the existing policies, procedures and processes to change what we realized were weaknesses. A spare cashier drawer that was set up for use at the IPL 617 W. Jefferson Street office was immediately transferred to 810 Barret Avenue and assigned for Public Protection use. This cashier drawer was kept in a locked file cabinet located in a room with restricted locks, which was the most secured area of the existing office space. The cashier was immediately trained on the former City of Louisville mainframe cashier system and she maintained the only keys to the room as well as to the file cabinet.

The deposit process was also immediately changed. Public Protection ceased taking deposits from other unrelated departments and we began making daily deposits. The cashier prepared the deposit and secured it in a locked moneybag. The moneybag was transported daily by the day shift ABC Investigator who signed a receipt for it and did not have a key to the locked moneybag. He then delivered the moneybag to IPL 617 W. Jefferson Street to the depositor who had the only other moneybag key. She then reconciled the deposit and delivered it to the Department of Finance. The deposit receipt and moneybag was then returned to Public Protection empty the next day during that day's deposit transfer. That process has now evolved even more since we have moved to 810 Barret Avenue. We now have a cashier, two backups and a depositor and backup. The cashier, who is the only cashier and does not accept revenue for transactions processed herself, prepares the deposit. It is then reconciled by our depositor and transported by the day shift ABC Investigator, who signs a receipt for it and takes it directly to the Department of Finance. The empty moneybag, receipt from finance and the deposit report, which prints at the cashier station at 617 W. Jefferson Street, are then returned to the cashier and depositor at 810 Barret Avenue. All transactions are conducted on the mainframe cashier / depositor system and are reviewed by the License & Permits Coordinator. There are both manual and automated checks and balances, the information is reviewed regularly and there are clear separation of duties in the process of

accepting funds and preparing funds for deposit. In addition, no miscellaneous fees are arbitrarily being charged without documentation, as they were before.

General Administration

Scope

Key Public Protection personnel were interviewed in order to review the operational and fiscal administration of licensing, alcohol beverage enforcement and associated activity. This included the processing and records management associated licensing and enforcement. The focus was on the overall management of license and enforcement duties administered by the Public Protection Division.

Twenty-one licensee and violation files were judgmentally selected from the period of March 1, 2001 through December 31, 2002. The review consisted of examining required processing forms, records management system files, fees due, revenue receipts and financial system statements to determine the completeness, accuracy, timeliness and appropriateness of activity processed. While some weaknesses were associated with specific activities, the following concerns were noted that applied to the general administration of Public Protection Division activities.

Observations

There were some problems noted with the administration of licensing and related activity. As a result, the internal control structure is weakened and its effectiveness impaired. Examples of problems include the following.

- Files do not adequately document the payment of fees and fines. Licensees are required by ordinance to pay license fees upon application and renewal of licenses. Records of license payments were not routinely present in the files, thus the deposit and posting of license fees could not be verified to deposits.
- The current computerized databases used to record licensee information do not include all applicants, only approvals. Also, other types of information are not recorded (e.g., amount paid, receipt number, employer names, license number, date of last update). This weakens the usefulness of these records as reference and monitoring tools. Efficiency may also be hampered since hardcopy files may have to be used instead of a computerized query.
- The Public Protection Division issues 14-day temporary licenses to escort and adult entertainment employees. However, the 14-day temporary license is not authorized by the applicable ordinances.
- Requirements prohibit applicants who have been convicted of various felonies or crimes of moral turpitude from obtaining certain licenses. Public Protection staff perform background checks using Jefferson County Police records. However, they only have access to records dating to the year 2000, making a thorough check impossible.
 - The only background check performed for charitable solicitors is done by using the Jefferson County Police records, which cuts off at the year 2000. The applicants are not required to supply a background check from Jefferson County or the City of Louisville.

- The armed security licensing office uses the Jefferson County Police records dating to the year 2000 for background checks. The applicant is required to submit a complete background check from the City of Louisville, but not Jefferson County.
- The escort and adult entertainment licensing offices use the Jefferson County Police records dating to the year 2000 for temporary background checks. The licensees are required to provide complete background checks, from both Jefferson County and the City of Louisville within 14 days.
- Public Protection does not provide detailed desk procedures for staff performing assigned tasks. This may lead to inconsistencies in administration and management of activities.

Recommendations

Appropriate Inspection, Permits and Licenses personnel should take corrective action to address the concerns noted. Specific recommendations include the following.

- Information contained in files, both computer and hardcopy, should be adequate to address routine reference needs. This includes specific licensee / business information, along with payment documentation.
- As previously noted, the implementation of the Inspections, Permits and Licenses permitting system should improve the usefulness and efficiency of computerized records management.
- All applicable policies and procedures should adhere to required guidelines (e.g. ordinances, etc.). In cases where changes are determined to be needed, applicable ordinances and policies should be amended to reflect the updated regulations.
- Management should ensure that the necessary levels of criminal / background checks are completed for the appropriate time period in accordance with documented requirements.
- Written policies and procedures for the public protection activity processing should be developed and updated periodically. These should correspond with and supplement applicable State statute, local ordinance and general Standard Operating Procedures. This documentation should be distributed to all applicable personnel. This manual should include sufficient detail for each job duty performed, copies of forms used and policies followed in the process. In addition, training of key personnel will help ensure consistent adherence to the requirements.

Department of Inspections, Permits and License Response

With the change from the former county systems to the former City of Louisville mainframe systems and upon completion of the first year's renewals, all files will include adequate documentation to reflect payment of all fees and fines. This is being done now on a case-by-case basis, but will not include all files until one renewal year cycle is completed. The mainframe system will also include all licensee information for both applicants and approvals.

Upon discovery of the issuance of unauthorized temporary licenses, that activity was immediately stopped. No licenses or permits will be issued unless done so in